EX PARTE OR LATE FILED

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January 21, 1999

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, NW
Room 222
Washington, D.C. 20554

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JAN 21 1999
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

NOTICE OF EX PARTE PRESENTATION

Re: **CC Docket No. 96-128**

Dear Ms. Salas:

The enclosed letter and memorandum were delivered to Kathryn Brown, Chief of Staff to Chairman William Kennard this morning. Identical letters were delivered to legal advisors Thomas Power (Chairman Kennard), Linda Kinney (Commissioner Ness), Paul Gallant (Commissioner Tristani), Kyle Dixon (Commissioner Powell), and Kevin Martin (Commissioner Furchtgott-Roth), to Common Carrier Bureau Chief Larry Strickling and legal assistant Rich Cameron, and General Counsel Christopher Wright.

Sincerely yours,

Robert F. Aldrich

Robert F. Aldrich

RFA/nw
Enclosure

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

January 21, 1999

Ms. Kathryn Brown
Chief of Staff
Office of William E. Kennard
Federal Communications Commission
445 12th Street, SW
Room 8-B201E
Washington, D.C. 20554

NOTICE OF EX PARTE PRESENTATION

Re: **CC Docket No. 96-128**

Dear Ms. Brown:

Cost-based dial-around compensation must include the costs incurred in collecting per-call compensation. These costs are real costs incurred by payphone providers and must be attributed to dial-around calling. Collection costs have been estimated by APCC at 4.3 cents per call and by the Bell companies at 4.5 cents per call.

In addition, cost-based dial-around compensation must include a fair share of the costs of payphone coin mechanisms. The enclosed memorandum,. prepared on behalf of the American Public Communications Council ("APCC") by economic consultants John Haring and Jeffrey Rohlfs of Strategic Policy Research, explains why a fair share of the cost of a payphone's coin mechanism[1] should be allocated to and recovered from cost-based per-call compensation for coinless payphone calls.

As discussed in the memorandum, coin mechanism costs are appropriately allocated among both coin and coinless calls because they are fixed costs that cannot be avoided by a caller making *either* a coin or *coinless* call. The economies of scope provided by the ability to use the phone for coin calls benefits both coin and coinless callers. Without the coin capability the payphone would not be installed, and it would not be possible for callers to make coin *or coinless* calls.

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[1] The Second Report and Order in this proceeding estimated the cost of a payphone cost mechanism to be 3.1 cents per call. However, the estimate is subject to change based on a number of variables, including payphone capital costs and the assumed number of calls per payphone.

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Indeed, a coinless call would cost more if made from a coinless phone than if made from a payphone with coin capability. The validity of this proposition and of the need to address economies of scope is demonstrated by the record in this proceeding. As the record shows, the vast majority of payphone locations could not support a coinless payphone, and the per-call costs at a coinless payphone are far higher than the per-call costs of either coin or coinless calls from the typical payphone with coin capabilities. See, e.g., APCC's comments, filed August 26, 1997, at 12, n.11 (per call costs at coinless payphone are $.65).

Thus, coinless calls benefit from the presence of the payphone's coin mechanism. It is inconsistent with economic principles to fail to allocate any of the fixed costs of coin capability to coinless calls.

In addition, allocating all such costs to coin calls is unfair to coin callers and exerts unnecessary upward pressure on local coin calling rates. There is no valid economic reason for coinless callers to receive a form of subsidy from coin callers by having coin callers bear the costs of scope economics that yield benefits to coinless callers.

Sincerely yours,

Albert H. Kramer

AHK/nw
Enclosures

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Issue: Should costs of the coin mechanism in a payphone station be recovered, in part, through per-call compensation for coinless payphone calls?

Response: Yes, because the costs of the coin mechanism are fixed and do not vary with the number or types of calls placed at a station. Most station costs, including those of the coin mechanism, are non-traffic-sensitive. The cost of the coin mechanism is not saved depending on whether a coinless or coin call is placed. The claim that coinless calls do not cause costs of the coin mechanism to be incurred *is equally true of coin calls*. Individual calls do not cause non-traffic-sensitive station costs; they are incurred by the decision to deploy individual pay stations, which is a function of anticipated demands for different types of calls and the cost of characteristics of different types of stations.

Where there are economies of scope between coinless and coin calling, costs of supplying the option of making either type of call are less than the "stand-alone" cost of supplying only one option or the other. When there are economies of scope, *each type of call benefits* from the existence of a machine that affords the opportunity to make the other type of call. Where there are economies of scope, consumers who make coinless calls enjoy benefits from the coin mechanism because it is what permits sharing of fixed resource costs. Makers of coinless calls cannot realize benefits from exploitation of economies of scope unless costs of the coin mechanism are incurred and recovered. If per-call compensation for coinless calls were not to recover a contribution for recovery of the non-traffic-sensitive costs of the coin mechanism, makers of coinless calls would receive the benefits (from cost-savings through realization of scope economies/avoidance of higher stand-alone costs) without shouldering any of the cost burden entailed in enabling the realization of scope economies in the first place— a clear case of wanting to eat your cake and still have it.

The empirical basis for these economies of scope can be found in the record of this proceeding. The record shows that the per-call cost of a coinless call made from a coinless-only payphone is much higher than the per-call cost of either a coin or coinless call that is made from a payphone with dual (coin and coinless) capabilities.

The economic issue is not how to allocate or apportion fixed costs but how to recover costs efficiently. Where fixed-cost burdens are to be recovered through usage-charges, that usually entails percentage mark-ups over variable costs in inverse proportion to demand elasticities.

That is, in fact, the nature of the FCC's recent access charge reforms, which afford IXCs flexibility in how they choose to recover assigned fixed cost burdens. The efficiency benefits of the reforms flow from the carriers' ability to load these burdens more economically taking into account perceived demand elasticities.

In the instant setting, setting compensation based on a cost-of-service methodology (specifically, one which attributes the fixed costs of the coin mechanism solely to coin calls) does not mimic market processes and is not economically efficient. It conveys upon IXCs the benefits of resource sharing, but does not require them to bear any responsibility for recovery of part of the fixed-cost burden that enables the benefits of resource sharing to be produced.

In adopting customer access line charges, the Commission specifically rejected the argument of consumers who said they should not have to pay such charges because they do not make any interstate long-distance calls. The customer's decision to have a line is what causes such cost burdens to be incurred. Additional burdens may be incurred by the collective decision to socialize part of the access burden to ensure universal service. The fact that a customer does not make long-distance calls does not mean that they do not enjoy benefits from network connectivity and universal service. To permit customers not to pay the CALC on the grounds that they do not make long-distance calls would, in effect, allow them to "free-ride" on the benefits of network connectivity and universal service.

The same arguments apply to pay station costs. The fact that some customers do not use the coin mechanism does not mean that they do not derive benefits from it. Where there are economies of scope, the coin mechanism permits them to pay less by affording the means for resource sharing. The fact that station costs (loop costs) are fixed and do not vary with payphone calling (long- distance calling)— indeed, are not costs of calling— does not absolve call charges from responsibility for their recovery.

It *is* economically desirable to recover fixed burdens efficiently. In this regard, the Commission should adopt a costing methodology that mimics the way costs would be recovered in an efficient market, just as it has done in the case of access burdens. Clearly, the market would not absolve coinless calls of *any* responsibility for recovery of the fixed costs of the coin mechanism. Indeed, that solution would harm *coinless* callers since it would preclude efficient deployment of payphone stations with or without coin capabilities. As Adam Smith remarked, "The division of labor is limited by the extent of the market." If suppliers are limited in their ability to recover costs efficiently by economically arbitrary regulations, a smaller number of payphone stations will be deployed and economies of scope will be exploited to a lesser extent. The amount of both coin and coinless calling will be arbitrarily and uneconomically limited by regulations that prevent full exploitation of available economies of scope.

John Haring

Jeff Rohlfs

I hereby swear and affirm that the statements contained in the attached Declaration are true and correct to the best of my knowledge and belief.

John Haring

John Haring

County of Montgomery

State of Maryland

Subscribed and sworn before me this 20th day of January 1999.

Adrienne Wells Vendig

Notary Public

My commission expires:_______________

Adrienne Wells Vendig, Notary Public
Montgomery County
State of Maryland
My Commission Expires Sept. 1, 2002

I hereby swear and affirm that the statements contained in the attached Declaration are true and correct to the best of my knowledge and belief.

Jeffy H Rohlfs

Jeffrey H. Rohlfs

County of Montgomery

State of Maryland

Subscribed and sworn before me this 20th day of January 1999.

Adrienne Wells Vendig

Notary Public

My commission expires:_______________

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